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UNCLAS SECTION 01 OF 02 SAO PAULO 000222

SIPDIS

SENSITIVE

STATE PASS USTR FOR KDUCKWORTH

STATE PASS EXIMBANK

STATE PASS OPIC FOR DMORONSE, NRIVERA, CMERVENNE

STATE PASS NSC FOR ROSELLO

DEPT OF TREASURY FOR LINDQUIST

E.O. 12958: N/A

TAGS: ECON ETRD BR

SUBJECT: BRAZIL: MUDDLING THROUGH WITH MERCOSUL

REF: 08 Sao Paulo 497

SENSITIVE BUT UNCLASSIFIED--PLEASE PROTECT ACCORDINGLY

¶1. (SBU) Summary: Mercosul is overly politicized and structurally defective, particularly for a major emerging economic power like Brazil, according to participants in a 4/7/09 Consulate-sponsored roundtable. However, membership in this organization provides some economic benefits to Brazil even if the country often finds itself at odds with some of members' protectionist policies. Brazil's policy of "muddling through with Mercosul" is entirely consistent with the general thrust of the country's foreign policy in South America, which seeks to avoid conflict, maintain stability, and advance regional integration, even as Brazil's own emergence as a major economic power causes its interests to diverge increasingly from those of its neighbors. End Summary.

¶2. (SBU) The Consulate General in Sao Paulo hosted a roundtable on Mercosul on April 7, 2009. Participants included a director for International Trade at the Federation of Industries of Sao Paulo, Mario Marconini, former Brazilian Ambassador to the U.S. Rubens Barbosa, Fundacao Getulio Vargas Professor Eliana Cardoso, Brazilian Society of Studies on Transnational Companies (SOBEET) representative Luis Alfonso Lima, Funcex representative Fernando Ribeiro, and National Confederation of Industry (CNI) representative Lucia Maduro.

Mercosul: For Brazil It's Politics vs. Economics

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¶3. (SBU) Roundtable participants agreed that Mercosul is more of a political than an economic instrument. Ambassador Barbosa characterized the organization as one of the "most politicized entities" of President Lula's administration. All agreed that Brazil's Mercosul challenges -- laid out below -- turn on the contradiction between Brazil's political inclinations and the country's economic self-interest. Nonetheless, Brazil will likely stick with the status quo for now. Mercosul membership costs little and still provides some benefits -- for now. Until this calculation changes drastically, Brazil will "muddle through" with Mercosul.

¶4. (SBU) Roundtable participants laid out a number of areas where Brazil finds itself constrained by Mercosul:

-- Institutional Obsolescence: Mercosul's "Factory Defect"

FIESP's Mario Marconini said that Mercosul possesses a "factory defect" in that the organization requires that members adopt a common market within four years, a process that took the European Union forty years.

-- Brazil Too Big for Mercosul...

Brazil is an economic powerhouse compared to Mercosul's other members and these economic asymmetries have led to fractures within the membership. While Brazil has led an aggressive campaign for international investments and markets for its world class industries, there are other, smaller fractures among the membership of Mercosul. Most notably, Mercosul was unable to resolve a dispute between Argentina and Uruguay over international investments in paper mills in Uruguay. Ambassador Barbosa noted that Brazil pushed hard for more open trade at the WTO, a position that clashes with the instincts of many Mercosul members like Argentina and pending member Venezuela.

-- ... But Wants to Be Popular

Ambassador Barbosa observed that Brazil's desire to be popular with its neighbors, motivated in part by ambitions to be a regional leader, causes the country to sweep economic differences with other Mercosul members under the rug. Brazil, for example, ignores attacks from other Mercosul members and had recently made a strategic decision to ignore a series of new tariffs that Argentina imposed on imports. Brazil calculates that its trade surpluses more than compensate for these minor indignities. Marconini noted, for

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example, that Argentina's new tariffs will affect only 20 percent of Brazil's exports to that country. Consequently, it is "simply not worth the trouble" for the GOB to raise a fuss over this issue.

Venezuela: A Problematic Partner

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¶15. (SBU) Caracas' possible membership in Mercosul encapsulates many of the contradictions described above. Brazil already has outstanding access to the Venezuelan market and the country's inclusion into Mercosul is likely to create complications for Brazil, given the two countries radically different approaches to trade. Nevertheless, panel participants treated Venezuelan accession to Mercosul as a given, that the GOB has already made a political decision to support Venezuela's membership. Lucia Maduro noted that Caracas already enjoys Mercosul member benefits without having to adhere to Mercosul rules. Ambassador Barbosa observed that bringing Caracas into the Mercosul fold was a way of preparing for a post-Chavez Venezuela and the expansion of the organization to other areas of the hemisphere, including the Caribbean.

The Case for "Muddling Through"

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¶16. (SBU) The consensus of the group was that Brazil would almost certainly "muddle through" with Mercosul for now, rather than either leaving the organization or pushing for fundamental reforms. Mercosul continues to provide some economic benefits, according to SOBEET's Alfonso Lima. Trade within the bloc has increased more than trade with other markets. Professor Cardoso noted that Brazil often can export lower quality products to Mercosul members that are not competitive elsewhere and that other countries are now using Brazil as a platform to export to the rest of Mercosul. In addition, she commented that Mercosul gives Brazil a unique laboratory in which to learn about "real world" trade problems that can arise among nations.

¶17. (SBU) Despite these benefits, Ambassador Barbosa, Mario Marconini, and Fernando Ribeiro argued that membership in Mercosul was likely to be a wasting asset and most agreed that the organization would lose the relatively little utility it currently has within the next 20 years. The asymmetry between an increasingly world-class, world-competitive Brazil and its protectionist fellow

members is simply too great. For now, however, the costs of the organization are relatively low and it still provides strategic, political benefits to Brazil in the region.

Comment

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¶8. (SBU) Brazil's approach to Mercosul fits in well with previous analyses of the country's overall foreign policy that seeks to maintain regional relationships while also aspiring to greater international stature (Reftel). While Brazil's emergence as a global economic power includes vigorous defense of the country's economic self-interest and a positioning appropriate to global opportunities, Brazil also remains wedded to maintaining good relations and stability in South America. This is patently the rationale in the short-term behind the GOB's support of Venezuelan membership in Mercosul, in light of the challenges Venezuela's inclusion would introduce into the Mercosul dynamic. Thus Mercosul serves Brazil's long-term political interests of advancing South American integration even if the economics of the entity provide only marginal benefits in what is undoubtedly a lop-sided grouping of economies. So long as these perceived political benefits dominate Brazil's calculus, Brazil will not rock the regional boat by either leaving or pushing for the reform of Mercosul, even if those observers who weigh economic interests more than political interests question the wisdom of this approach. End Comment.

¶9. (U) This cable has been cleared by the Financial attach in Sao Paulo and the Embassy in Brasilia.

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